Agriculture Financial Services Corporation's (AFSC)

# QUARTERLY REPORT

## 2015-16

(First Quarter Update - June 30,2015)

AFSC is in the business of helping Albertans achieve prosperity and build successful businesses.

**First Quarter Update – as of September 1, 2015**
**Agriculture Financial Services Corporation**

## Nature of Operations

Agriculture Financial Services Corporation (AFSC) is a Crown Corporation that is in the business of helping rural Albertans achieve prosperity and build successful businesses. Through strategic risk management and income stabilization programs for farm clients, and forward-thinking lending programs for both urban and rural entrepreneurs, AFSC provides Alberta businesses the valuable tools they need to thrive.

## Overview

### Economic Climate

Alberta's economy has slowed during the first quarter of the fiscal year primarily due to continuing low oil prices. The price of oil climbed slightly from $52.46 per barrel on March 31, 2015 to $61.31 per barrel at the end of First Quarter. The Canadian dollar declined in value relative to the United States dollar, from $0.79 March 31, 2015 to $0.75 First Quarter.

The agricultural commodity prices for the livestock and grains and oilseeds sectors increased slightly.

The prime rate at Canada's major banks remained the same as of March 31, 2015 at 2.85 per cent.

### Annual crop conditions

The early snow melt allowed producers to get a head start on seeding in all areas but particularly in southern Alberta. By the end of May, nearly 95 per cent of the province had been seeded which was one week ahead of the 5-year average. Provincially, 54 per cent of seeded crops had already emerged, but were showing slow growth due to extremely dry conditions and cool nights in many parts of the province.

The lack of rain has affected crops in many areas across the province. Seventy per cent of surface soil moisture conditions were rated good to excellent in early May; however, this dropped to just 21 per cent by the end of June (June 2014 – 78 per cent). Provincially in mid-June crop growing conditions were rated 41 per cent good to excellent, and declined to 30 per cent by the end of June (June 2014 – 83 per cent), the lowest experienced since 2009.

### Perennial crop conditions

Perennial crops were also impacted by the lack of moisture throughout the province in the First Quarter. Hay and pasture crops were slow to start in early spring due to dry conditions and the cold evening temperatures, with 69 per cent rated in good or excellent condition. By the end of May, pasture conditions and tame hay growth continued to decline with only 34 per cent rated good or excellent.

During the month of June, grasses and legumes had stopped growing and were turning brown. Plant growth was short which affected first cut hay harvest. First cut haying operations started in the South and Central Regions in mid-June.

At the end of June hay and pasture conditions declined to only 17 per cent rated good or excellent (June 2014 – 86 per cent). First cut haying was underway in all regions with the exception of the North Area with poor yields and quality down due to high stem content.

## First Quarter Update

### Operations

At the end of the first quarter, AFSC had a total revenue of $615 million principally from the collection of premiums for the new crop year (June 2014 - $546 million).

A number of corporate initiatives were underway, including the creation of a Dry Conditions Response Team and preparation for the launch of AFSC on Twitter. The Dry Conditions team, which consists of staff members from AFSC and Agriculture & Forestry , has been developing information for clients, the shareholder and media, about conditions in the province, program information and claim numbers. This information has been shared on Call of the Land, the AFSC external website and other communications tools.

## Lending

AFSC authorized new direct loans and guarantees for the first quarter of 2015-16 totaling $172.6 million as compared to $142.5 million for the first quarter in the previous fiscal period and is on track in meeting the 2015/16 target of $558 million. This lending facilitated an investment of $269.4 million in the province's agriculture, agri-industry and value-added sectors.

The total outstanding loan portfolio of $2.2 billion at the end of the first quarter grew by 2.1 per cent which was similar growth to first quarter last year. Year over year growth was 6.1 per cent which is below target due to clients making additional payments above what is scheduled.

Lending operating costs for the first quarter were 0.3 per cent of the loan portfolio and is tracking slightly higher than the prior year and the target due to filling key positions to meet client demand and slower than expected portfolio growth.

Alberta Farm Loans, Revolving and Commercial loans are all up over the 2014-15 fiscal period, with VAAP Loans slightly below 2014-15 levels. Due to increased demand for AFSC's lending products the corporation has enhanced the staff complement to ensure that resource levels are suitable to meet the needs of the clients.

Commercial lending has remained stable with moderate growth over last year. In general our existing commercial clients have been experiencing the effects of the downturn in the oilfield which has directly impacted our commercial arrears. This has resulted in commercial arrears increasing from 3.8 to 5.7 per cent over the previous year. This was not unexpected as our arrears percentage in 2014 was at an all-time low due to the strength of the economy.

Farm lending through the Alberta Farm Loan Program continues to be very strong especially in the financing of land purchases. Farm loan arrears remain low at 0.5 per cent (2014 – 0.8 per cent). Despite the drought conditions in the province AFSC is only beginning to see requests about restructuring.

In early June the Revolving Loan Program was amended to change the general requirement for principal repayment to individualized repayment based on cash flow. This has resulted in increased participation in the program.

Under the Specific Loan Guarantee Program for Feeder Associations AFSC processed six applications in the first quarter totaling $750,000. There are currently 21 separate guarantees outstanding under this program for a total of $6.1 million.

Interest rate rebates totaling $864,294 ($165,355 in the first quarter of this year) have been paid out with respect to the Alberta Flood Recovery programs.

## Lending Operating Results

| | Lending volume for year | | Portfolio loans outstanding | |
|---|---|---|---|---|
| | Number of loans | Amount lent ($M) | Number of loans | Amount outstanding ($M) |
| **2015-16 (1st quarter)** | | | | |
| Farm | 575 | 145.16 | 10,816 | 1,709.79 |
| Commercial | 37 | 19.20 | 921 | 289.48 |
| Value-Added and AgriBusiness | 19 | 8.21 | 409 | 164.95 |
| Total | 631 | 172.57 | 12,146 | 2,164.22 |
| **2014-15 (Annual)** | | | | |
| Farm | 1,777 | 400.05 | 10,670 | 1,634.98 |
| Commercial | 172 | 77.68 | 926 | 276.63 |
| Value-Added and AgriBusiness | 84 | 45.14 | 410 | 165.88 |
| Total | 2,033 | 522.87 | 12,006 | 2,077.49 |
| **2013-14 (Annual)** | | | | |
| Farm | 1,770 | 391.59 | 10,386 | 1,487.61 |
| Commercial | 232 | 95.54 | 1,008 | 302.31 |
| Value-Added and AgriBusiness | 102 | 63.94 | 405 | 169.41 |
| Total | 2,104 | 551.07 | 11,799 | 1,959.33 |
| **2012-13 (Annual)** | | | | |
| Farm | 1,857 | 384.93 | 9,969 | 1,366.17 |
| Commercial | 258 | 115.39 | 1,018 | 280.97 |
| Value-Added and AgriBusiness | 103 | 52.58 | 362 | 142.56 |
| Total | 2,218 | 552.90 | 11,349 | 1,789.70 |

M=Million

## Lending Operating Results

| | 2015-16 Target | 2015-2016 (1st qtr.) | 2014-15 (Annual) | 2013-14 (Annual) | 2012-13 (Annual) |
|---|---|---|---|---|---|
| Annual lending volume ($M) | 558 | 173 | 523 | 551 | 553 |
| Loans outstanding ($M) | 2,276 | 2,164 | 2,077 | 1,959 | 1,790 |
| Admin. cost ($M) | 24.81 | 6.49 | 24.51 | 22.97 | 23.01 |
| Write-offs ($M) | ** | ** | 3.50 | 1.75 | 8.34 |
| Operating surplus [deficit] | 0 | .93 | 4.51 | 12.53 | [4.00] |

M=Million
** To be determined as information becomes available.

## Lending Delivery Effectiveness

| | 2015-16 Target | 2015-2016 (1st qtr.) | 2014-15 (Annual) | 2013-14 (Annual) | 2012-13 (Annual) |
|---|---|---|---|---|---|
| Portfolio growth (% year over year) | 10 | 2.1 | 6.1 | 9 | 11 |
| Operating costs (% of portfolio) | 1.20 | 0.31 | 1.18 | 1.17 | 1.29 |
| Write-offs (% of portfolio) | ** | ** | 0.17 | 0.09 | 0.47 |
| **Benchmark comparison** | | | | | |
| Gov't lending average portfolio growth (% year over year) | ** | ** | † | 9.38 | 8.38 |
| Gov't lending average overhead burden (% of portfolio) | ** | ** | † | 1.54 | 1.63 |
| Gov't Lending average write-offs (% of portfolio) | ** | ** | † | 0.60 | 0.42 |

AFSC= Agriculture Financial Services Corporation (GOA) FCC= Farm Credit Canada (GOC) BDC=Business Development Bank of Canada (GOC) MASC=Manitoba Agriculture Services Corporation (GOM)

† Benchmark comparators not available for some organizations
** To be determined as information becomes available.

## Insurance

AFSC insured a record of 14.691 million annual crop acres (2014 – 14.539 acres). AFSC insured 6.694 million acres of perennial crops, compared to 6.785 million in 2014.

There are 13,130 active annual crop insurance subscriptions for 2015, down from 13,304 in the 2014 crop year. This reflects 895 cancelled and 721 new subscriptions. Coverage levels for 2015 were: 80 per cent or more coverage – 51.6 per cent of subscriptions (2014 – 49.3 per cent); 70 per cent coverage - 32.3 per cent (2014 – 33.4 per cent); less than 70 per cent coverage – 16.1 per cent (2014 – 17.3 per cent).

The trend of increased average crop acres insured per subscription continued with 2015 being 1,282 acres per subscription compared to 1,218 in 2014.

Perennial insurance subscriptions declined from 6,012 in 2014 to 5,600 in 2015, reflecting 635 subscriptions cancelled and 223 new subscriptions.

During the first quarter On Farm Inspections (OFI) completed 449 reseed claims. There was some localized hail that generated 981 hail claims mostly in the South area. There were 265 pre-harvest inspections completed for clients putting their crops to another use. These compare to 149 reseed claims, 287 hail claims, and 46 pre-harvest inspections in the first quarter of 2014/15. We will begin reporting actual turnaround times for inspections in the second quarter.

For the 2015 crop year, AFSC introduced two new products to Insurance:

### New Crop Insurance Initiative

The New Crop Insurance Initiative (NCII) is a new type of insurance concept available to clients that produce new and non-traditional crops that are not currently covered by traditional multi-peril coverage insurance (MPCI). This new program addresses an existing gap in MPCI by providing producers a base level of insurance protection and access to the Hail Endorsement. The expected uptake for the start of the program in 2015 was 21 clients with coverage on 5,551 acres. Actual results were 23 clients insuring 12 different crops covering 3,102 acres under NCII for the 2015 crop year.

### Hemp

As a result of conversations with processors and Alberta growers, AFSC created an irrigated Hemp Grain Insurance product which was implemented in the 2015 crop year. AFSC worked extensively with industry to get information on the program design details, including agronomic, risk profile and market components. The business case for the program predicted that a significant portion of Straight Hail clients with irrigated hemp would migrate toward Crop Insurance with the Hail Endorsement. The outcome was as expected, with Hemp acres covered by Straight Hail dropping from 19,654 acres in 2014 to 11,272 in 2015, with an uptake of 10,133 acres in the new program. For the 2015 crop year, there are 40 clients insuring 10,133 acres under the new Crop Insurance program, with 95 per cent taking the Hail Endorsement.

## AgriInsurance Operating Results

| | 2015-16 Target | 2015-16 (1st qtr.) | 2014-15 (Annual) | 2013-14 (Annual) | 2012-13 (Annual) |
|---|---|---|---|---|---|
| Number of policies | ** | 28,596 | 29,028 | 31,028 | 31,079 |
| Number of acres insured (M) | 34.47 | 34.47 | 34.96 | 36.00 | 34.87 |
| Amount of risk ($M) | ** | 7,118.23 | 6,799.33 | 8,611.45 | 8,991.73 |
| Amount of premium ($M) | ** | 602.96 | 584.83 | 780.43 | 662.57 |
| Amount of admin cost ($M) | 39.12 | 9.46 | 38.40 | 34.41 | 34.47 |
| Indemnities ($M) | *** | *** | 370.21 | 308.56 | 551.20 |
| Loss to premium ratio (%) | *** | *** | 63.30 | 39.5 | 83.20 |
| Operating surplus (deficit) ($M) | 0.00 | *** | 229.03 | 469.09 | 102.64 |

M=Million
** To be determined as information becomes available.
Note: Insurance performance measures include information for base programs as well as endorsements.
*** Operating results will be available starting in the second quarter.

## AgriInsurance Delivery Efficiency

| | 2015-16 Target | 2015-2016 (1st qtr.) | 2014-15 (Annual) | 2013-14 (Annual) | 2012-13 (Annual) |
|---|---|---|---|---|---|
| Admin./policy ($) | 1,370 | 331 | 1,324 | 1,109 | 1,108 |
| Admin./acre ($) | 1.13 | 0.27 | 1.10 | 0.96 | 0.99 |
| Admin./risk (%) | 0.55 | 0.13 | 0.57 | 0.40 | 0.38 |
| Admin./premium (%) | 6.50 | 1.59 | 6.57 | 4.41 | 5.20 |
| Benchmark comparison | | | | | |
| Admin./policy ($) | ** | ** | † | 1,292 | 1,269 |
| Admin./acre ($) | ** | ** | † | 1.11 | 1.11 |
| Admin./risk (%) | ** | ** | † | 0.51 | 0.59 |
| Admin./premium (%) | ** | ** | † | 4.20 | 4.80 |

The benchmark is a combination of Saskatchewan Crop Insurance Corporation and Manitoba Agriculture Services Corporation.
** To be determined as information becomes available.
† Benchmark comparators not available for some organizations

## Straight Hail Operating Results

During the first quarter, AFSC billed 3,137 straight hail subscriptions covering $470 million of risk on 3.15 million acres, generating $39.1 million in premium. (This compares to 3,207 subscriptions and $40M in premiums in the first quarter of 2014-15). There had been 332 straight hail claims in the first quarter (compared to 89 claims for the first quarter of 2014-15). We will begin reporting actual turnaround times for inspections in the second quarter.

| | 2015-16 (1st qtr.) | 2014-15 (Annual) | 2013-14 (Annual) | 2012-13 (Annual) |
|---|---|---|---|---|
| Number of policies | 3,137 | 4,648 | 4,895 | 5,815 |
| Number of acres insured (M) | 3.15 | 4.84 | 4.94 | 5.58 |
| Amount of policy risk ($M) | 470.48 | 711.42 | 589.83 | 625.90 |
| Amount of premium ($M) | 39.13 | 56.04 | 47.00 | 47.17 |
| Admin. cost ($M) | 0.401 | 2.31 | 2.55 | 3.10 |
| Indemnities ($M) | 1.60 | 61.23 | 37.76 | 58.51 |
| Loss to premium ratio (%) | ** | 109 | 80 | 124 |
| Operating surplus [deficit] ($M) | ** | [8.84] | 4.71 | [8.17] |
| Market share of straight hail premium (%) | ** | 60 | 55 | 59 |
| Market share of total hail premium (%) | ** | 87 | 89 | 88 |

M=Million
**To be determined as information becomes available.
Income Stabilization administrative costs include Alberta's share of AgriInvest administration costs, which Benchmarks do not.

## Western Livestock Price Insurance Program (WLPIP)

April 8th marked the first full year of operation of livestock price insurance under the Western Livestock Price Insurance Banner (WLPIP) and May 28th brought the 2015 WLPIP Calf sales period to a close. Alberta insured approximately 200,000 calves this year versus 330,000 calves in 2014. Coverage saw a major change from a year ago when top coverage in May, 2014 was $212 and by comparison this year the top index was offered at $284. First quarter policies sold for 2015-16 totaled 1,444 compared to 2,735 policies sold in the first quarter of 2014-15. For Alberta, insured units sold year to date (June 30, 2015) totaled 1,235,558 compared to 2,654,069 insured units sold year to date last year (June 30, 2014). Liability coverage is lower this quarter as well, dropping from $507M in the first quarter of 2014-15 to $306M this quarter. Premiums collected dropped from $5.9M in the first quarter of 2014-15 to $3.3M collected this quarter.

Supply and demand fundamentals appear to still be at a point where livestock prices will be firmly supported for the 2015 year. Producer consensus appears to be that given the general level of optimism in the prices for calf, feeder and fed livestock sectors, they have chosen not to purchase livestock price insurance to the level of last year's numbers. Producers felt that even if prices were to fall marginally, their break-even costs would still be covered.

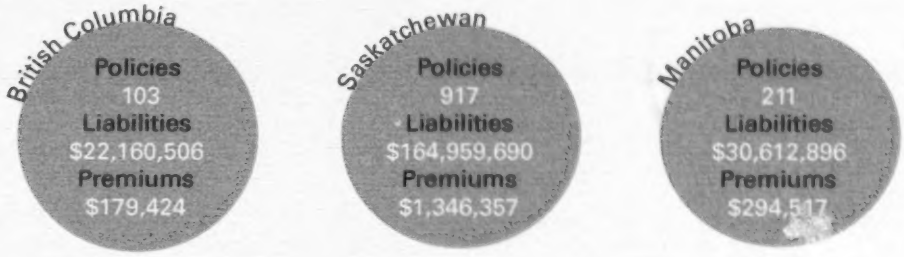
While there are other contributing factors impacting the premium shortfall year to date for WLPIP, the overall market strength for strong prices continues to be the main driver for this producer optimism at this point. All provinces are working on consistent messaging for advertising and a targeted strategy coupled with a strong education component for staff and clients as we now gear up for the Feeder and Fed sales period this fall. Low uptake by hog producers of the hog policy options available continues to be a problem for WLPIP. High premium cost, due in part to the higher price volatility in the hog market, and provision of relevant coverage levels for this industry are cited as the two main reasons for limited hog policy sales.

Drought and feed impacts on livestock operations are among the list of growing concerns from producers. Some evidence of increased sales of cull animals and older breeding stock have started to occur in Alberta without the corresponding increase in heifer retention, which is in contrast to the herd expansion witnessed in the United States. AFSC continues to monitor these emerging issues in order to determine the impact to the program and potential for indemnities.

## WLPIP Operating Results

| | Policy option | Policies | Liabilities ($) | Premiums ($) | Assessments | Indemnity | Loss to premium |
|---|---|---|---|---|---|---|---|
| **Alberta** | | | | | | | |
| | Calf | 1,126 | 215,300,144 | 2,096,812 | ** | ** | ** |
| | Fed | 11 | 17,795,280 | 151,101 | ** | ** | ** |
| | Feeder | 307 | 72,887,064 | 1,047,604 | ** | ** | ** |
| | Hog | 0 | 0 | 0 | ** | ** | ** |
| Total | | 1,444 | $305,982,488 | $3,295,517 | | | |

**To be determined as information becomes available.




## AgriInvest

AgriInvest is a matching-deposit based program for producers facing margin declines. The program is administered by the federal government and assisted by AFSC as necessary to support Alberta producers. AgriInvest funds, including the government contribution, can be withdrawn at any time for any reason including to cover margin declines or to invest in certain activities to improve farm income.

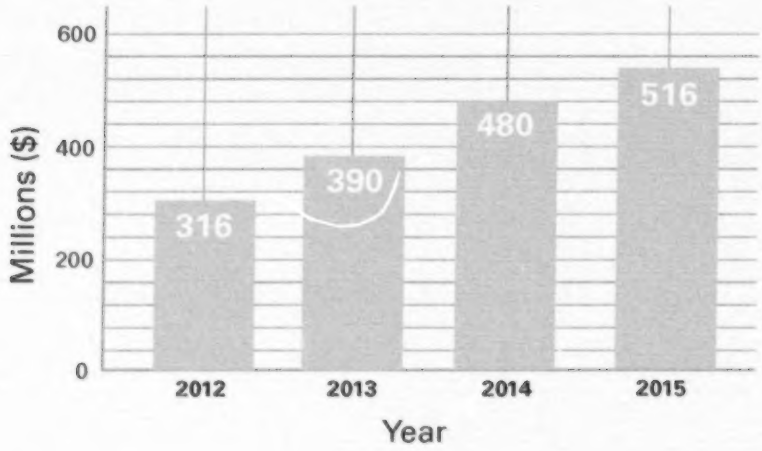
Under the GF2 Program Guidelines, federal and provincial governments will match producers' contributions (cost-shared Federal 60 per cent, Alberta 40 per cent) up to one per cent of their Allowable Net Sales (ANS) (subject to eligibility) to a maximum of $15,000 per year. Producers are able to contribute up to one per cent of their ANS annually, and carry a maximum account balance of 400 per cent of the three year ANS average. Since the inception of AgriInvest in 2007, Alberta producers have withdrawn $362 million in government funds.

As of June 30, 2015, 27,227 Alberta producers had $535 million on deposit in their AgriInvest accounts.

| Year | Number of Producers Depositing | Total Value of Contributions by Producer ($) | Total Value of Contributions by Government ($) |
|---|---|---|---|
| 2014 | 22,447 | 12,109 | 12,109 |
| 2013 | 21,715 | 60,151 | 60,151 |
| 2012 | 22,636 | 90,087 | 90,087 |

$ = Thousands

AgriInvest Balance of Funds on Deposit as of March 31:




## AgriStability

AgriStability claims are processed on a one-year lag basis. In the first quarter the team was ending the processing cycle for 2013 program year and starting 2014. In the 2013 production year, commodity prices for grains were strong coming into the year, but weakened by the end due to bumper crop production. This trend continued and as a result the 2014 crop prices have basically returned to the early 2012 levels.

Cattle prices continued to increase in 2014 resulting in record breaking prices driven by an overall shrinkage in worldwide supply. In 2014 bred cow prices increased by approximately 70 per cent and feeder prices increased by approximately 50 per cent over the course of the 2014 year. So far in 2015 cattle prices are appearing to level off with 2015 Feeder prices increasing by approximately 10 per cent since January.

As of June 30, 2015, the 2013 program year has paid benefits to 10 per cent of the 16,438 claims received totaling $51.68 million in payments. For the 2014 program year we have received 4,622 claims to date and have paid $ 3.4 million in payments.

The corporate turnaround goals for the 2014 program year have changed and are as follows: 80 per cent of payment claims paid within 45 days and 80 per cent of non-payment claims within 65 days. As of July 9th, the 2014 program year results are - 72 per cent of payment claims within 45 days and 89 per cent of non-payment claims within 65 days.

The average support level for producers has decreased from $197,180 in 2012 to $191,873 in 2013. This is the result of the Tier 2 removal and the introduction of the reference margin limits, which were implemented for the 2013 program year. We will continue to monitor the 2014 program year support levels and will report when we have a larger sample size.

## AgriStability Claims by Industry

| Industry | Agristability claims ($M) | Denied AgriStability claims ($M) | AgriStability claims > $0 ($M) | AgriStability ($M) |
|---|---|---|---|---|
| **2014 Program Year** | | | | |
| Livestock | 277 | 7 | 9 | 0.20 |
| Crop | 545 | 12 | 71 | 3.11 |
| Other | 33 | 2 | 2 | 0.03 |
| Total | 855 | 21 | 82 | 3.34 |
| **2013 Program Year** | | | | |
| Livestock | 3,963 | 57 | 617 | 32.81 |
| Crop | 7,385 | 100 | 932 | 16.83 |
| Other | 855 | 41 | 78 | 2.04 |
| Total | 12,203 | 198 | 1,627 | 51.68 |
| **2012 Program Year** | | | | |
| Livestock | 4,994 | 138 | 728 | 32 |
| Crop | 8,670 | 203 | 561 | 13.83 |
| Other | 1,295 | 59 | 135 | 1.63 |
| Total | 14,959 | 400 | 1,424 | 47.47 |
| **2011 Program Year** | | | | |
| Livestock | 6,586 | 179 | 825 | 23.94 |
| Crop | 9,790 | 352 | 1,188 | 19.47 |
| Other | 1,570 | 82 | 198 | 5.52 |
| Total | 17,946 | 613 | 2,211 | 48.93 |
| **2010 Program Year** | | | | |
| Livestock | 8,281 | 170 | 2,232 | 57.72 |
| Crop | 10,263 | 231 | 1,543 | 56.63 |
| Other | 1,837 | 97 | 366 | 14.68 |
| Total | 20,381 | 498 | 4,141 | 129.04 |

M=Million

## AFSC AgriStability Cost Effectiveness

| | 2015-16 (1st qtr.) | 2014-15 (Annual) | 2013-14 (Annual) | 2012-13 (Annual) |
|---|---|---|---|---|
| Admin. cost ($M)* | 4.08 | 18.41 | 18.01 | 19.07 |
| Less AgriInvest ($M) | (0.41) | (1.52) | (1.55) | (1.77) |
| Net AgriStability admin cost ($M) | 3.67 | 16.89 | 16.46 | 17.30 |
| Number of files processed | 3,942 | 15,244 | 17,825 | 21,458 |
| Cost per file ($) | 931 | 1,108 | 923 | 806 |
| Benchmark - cost per file ($) | ** | † | 989 | 811 |

The cost per file benchmark represents Saskatchewan Crop Insurance Corporation, Manitoba Agriculture Services Corporation and Agricorp Ontario.

M=Million
* Income Stabilization administrative costs include Alberta's share of AgriInvest administration costs, which Benchmarks do not.
† Benchmark comparators not available for some organizations
** To be determined as information becomes available.